COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, April 20, 1999

COMMONWEALTH OF VIRGINIA, ex rel.

MIKE DEANE, *et al.*

v. CASE NO. PUE980059

BOTETOURT FOREST WATER CORPORATION,
Defendant

FINAL ORDER

On January 10, 1998, Botetourt Forest Water Corporation ("Botetourt Water" or "Company") notified its customers of its intent to increase its rates for water service effective March 1, 1998, pursuant to the Small Water or Sewer Public Utility Act ("Small Water Act") (§ 56-265.13.1 et seq. of the Code of Virginia). The Company proposed to increase the monthly charge for the first 2,000 gallons from $16.00 to $17.00 and to increase the monthly price for each additional 1,000 gallons from $5.00 to $5.50. By February 18, 1998, approximately 26% of the Company's customers had filed objections with the Commission.

On March 5, 1998, the Commission, pursuant to § 56-265.13:6 of the Code of Virginia, issued a Preliminary Order declaring rates interim and subject to refund, with interest, as of March 5, 1998. On March 18, 1998, the Commission entered an

Order for Notice and Hearing in which it directed the Company to provide public notice, established a procedural schedule, assigned the matter to a Hearing Examiner ("Examiner"), and scheduled the matter for public hearing on September 15, 1998.

The evidentiary hearing on the proposed tariff revisions was held in Richmond on September 15, 1998, before Hearing Examiner Alexander F. Skirpan, Jr. Counsel appearing were: Kenworth E. Lion, Jr., Esquire, counsel to Botetourt Water; and Allison L. Held, Esquire, and Marta B. Curtis, Esquire, counsel for the Commission's Staff. Proof of public notice was marked as Exhibit Company-1 and admitted into the record. Botetourt Water and the Commission Staff ("Staff") filed limited briefs on October 16, 1998.

In this case, there were six issues related to the level of lawful and necessary expenses which, in turn, are used to measure the sufficiency of revenues. They were: (1) salaries and wages; (2) office rent expense; (3) equipment rental expense; (4) mileage expense; (5) rate case expense; and (6) health insurance expense. There were also issues concerning connection fees.

The issue with the greatest impact on the ultimate rates to be set in this case concerned the determination of salaries and wages. Specifically, Mr. and Mrs. Bowen sought wages of $18,000 and $24,000, respectively. The Staff, on the other hand,

recommended a salary of $11,232 for Mr. Bowen and a salary of $4,708 for Mrs. Bowen. The disparity in the recommended salaries was based on: (i) whether or to what extent the Bowens were entitled to compensation for being on call twenty-four hours a day; (ii) establishing the appropriate number of hours the Bowens devoted to operating Botetourt Water; and (iii) ascertaining a fair rate of compensation for the services provided by the Bowens. The Examiner recommended salaries for Mr. and Mrs. Bowen of $13,500 and $4,985, respectively.

The second issue in this case related to the office rent expense for the 30' by 18' office the Bowens operate out of their home. The Company argued that, although the office is used to operate two other businesses, 90% of the total rent expense should be assigned to Botetourt Water. Staff recommended that 50% of the total rent expense be assigned to Botetourt Water, considering that the office houses two other businesses. Since the Company's requested rent expense only materialized on rebuttal and was supported solely by Mr. Bowen's estimate of usage, the Examiner found that Staff's recommendation was reasonable.

The third issue concerned the use and expense of a backhoe and a pressure washer owned by Mr. Bowen. Staff found that a comparable backhoe and pressure washer rent for $215 and $72 per day, respectively. Based on this information, Staff added $500

to test year operating expenses to reflect approximately two days' use for the backhoe and one day's use for the pressure washer. The Company argued that the backhoe was used 52 times during the test year, and therefore asserted that Staff's adjustment for backhoe usage should be increased to $11,252. The Examiner found that, based on the record, Staff's expense adjustment of $430 was a more reasonable estimate than the Company's $11,252.

Fourth, Botetourt Water failed to include any mileage expense in test year operating expenses. Staff estimated the number of miles driven by the Company's employees to be approximately 1,235 miles, and included a mileage expense of $383 based on the standard Internal Revenue Service rate of $0.31 per mile. The Company argued that the Staff's mileage adjustment understated the actual miles driven by its employees and should be increased to $3,180.60. The Examiner found that the record supported the inclusion of 2,300 miles, and therefore recommended that the mileage expense be increased to $713.

The fifth issue in the case concerned rate case expenses. Initially, Staff recommended the Company's estimated rate case expense of $700 be amortized over two years. In his rebuttal testimony, Mr. Bowen increased the Company's estimated cost for this case from $700 to $2,700 based on new estimates reflecting that the case would be contested before the Commission. During

the hearing, Staff witness Barker accepted the Company's new estimate, but recommended that the amortization period be changed from two to three years. Mr. Bowen did not offer testimony in opposition to a three-year amortization period. The Examiner found that Staff's proposal to amortize rate case expense over three years was reasonable and recommended its adoption.

The sixth issue dealt with the health insurance purchased on behalf of Mr. and Mrs. Bowen. In his rebuttal testimony, Mr. Bowen requested that operating expense be increased by $1,776 to reflect the costs of health insurance purchased on behalf of Mr. and Mrs. Bowen. Because this adjustment was proposed in rebuttal testimony, Staff did not have an opportunity to verify the cost. Therefore, Staff did not support inclusion of this expense in the cost of service. However, Staff witness Barker testified that if such an adjustment were made, this expense should be based on the number of hours worked annually compared to a full-time position. At the Company's request, Exhibit JBB-C-8 was reserved for the late filing of support for Botetourt Water's claimed health insurance. On October 15, 1998, Botetourt Water, by counsel, filed Exhibit JBB-C-8, which consisted of a cover page showing health care costs for 1997 and for the first three quarters of 1998, and additional attached pages providing what appeared to be copies of the monthly checks

used to pay for the health care costs for Mr. and Mrs. Bowen. Exhibit JBB-C-8 supported Mr. Bowen's claim for health care costs of $296 per month. Therefore, the Examiner recommended that, following the Staff's proposed allocation methodology, $738, or approximately 20.77% of the total annual health care costs of $3,552, be added to operating expenses.

The final, and perhaps most controversial, issue in this case concerns the Company's collection of connection fees since 1994. During its review of Botetourt Water, Staff discovered that in 1994 the Company instituted a $500 connection fee. In addition, in 1997, Botetourt Water collected $1,000 in connection fees from each of two new customers located outside its certificated service territory. Through the end of 1997, Botetourt Water had collected $8,970 in connection fees. Neither the $500 nor $1,000 fees were specified in Botetourt Water's tariffs on file with the Commission. Consequently, Staff recommended that the Commission order the Company: (1) to cease charging connection fees and refund all connection fees collected by the Company to the affected customers; and (2) to request an amendment to its certificate of public convenience and necessity to expand its service territory to include all customers and any other areas of possible future expansion. The Company argued that its failure to provide notice to its customers and the Commission, as required by § 56-265.13:5 B,

does not prejudice existing customers, since the notice must only be provided to customers of the utility that are already connected to the system. Thus, any failure to provide notice of the institution of a new connection charge for new customers does not prejudice existing customers. The Company also argued that even if it lacked the authority to implement a connection charge in 1994, it would be unfair to penalize the customers connected to the water system prior to 1994 by requiring the utility to refund connection fees collected from 1994 through 1997. The Hearing Examiner recommended that the Company be ordered to refund, with interest, all connections fees collected prior to March 5, 1998. The Examiner reasoned that any result other than a refund would permit the Company an unauthorized change in tariff.

On January 8, 1999, the Hearing Examiner filed his Report. The Examiner found that:

1. The use of a test year ending December 31, 1997, is proper in this proceeding;

2. The Company's test year operating revenues, after all adjustments, were $48,504;

3. The Company's test year operating revenue deductions, after all adjustments, were $42,641;

4. The Company's test year net operating loss and adjusted net operating income, after all adjustments were $(16,439) and $5,863, respectively;

5. The Company's current rates produce a return of 16.28%;

6. The Company's current cost of capital, upon which its rates should be established, is 18.64%;

7. The Company's adjusted test year rate base is $36,014;

8. The Company's application requesting an annual increase in revenues of approximately $3,313 is unjust and unreasonable because it will generate a return on rate base greater than 18.64%;

9. The Company requires $870 in additional gross annual revenues to earn an 18.64% return on rate base;

10. The Company's existing rate structure should be maintained. The monthly rate for the first 2,000 gallons of usage should remain at $16.00. The annual increase of $870 should be added to the consumption charge for monthly usage in excess of 2,000 gallons, which currently is $5.00 per thousand gallons;

11. The Company should institute a connection fee for the installation of new connections of $500.00 or actual cost, whichever is greater. The Company should begin collecting these

fees as of March 5, 1998, the date rates from this case were permitted to take effect, subject to refund;

12. In its next case, the Company shall file cost information in support of its connection fee;

13. The Company should file permanent rates designed to produce the additional revenues found reasonable herein using the revenue apportionment methodology proposed by the Staff and described above;

14. The Company should be required to refund, with interest, all revenues collected under its interim rates in excess of the amount found just and reasonable herein;

15. The Company also should be required to refund, with interest, all connection fees collected prior to March 5, 1998, over three years, in three annual installments; and

16. The Company forthwith shall provide proper notice and submit a proper filing with the Commission seeking approval to serve customers outside its currently certificated service territory.

The Examiner recommended that the Commission enter an Order that adopts the findings in his report; grants the Company an increase in gross annual revenues of $870; and dismisses this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

On February 8, 1999, both the Staff and the Company filed exceptions and/or comments on the Examiner's Report. With regard to expenses, the Company took exception to the Examiner's recommended allowances for Mr. Bowen's annual salary, Mrs. Bowen's annual salary, office rental, equipment rental, and vehicle mileage. With regard to both Mr. and Mrs. Bowen's salary, the Company's core contention is that both continue to perform all of their duties during the four months of the year they lived in Florida, contrary to the Staff's testimony, and they should therefore be compensated for that time. The Company did not take exception to the hourly wage rates used by the Examiner. With regard to the office rental expense, the Company maintains that it satisfied its burden of proof with respect to the size of the office, the market price for the office space per square foot, and the use of the space for the Company's business.

The Company also states that the record contains uncontradicted evidence that the backhoe was used 52 times during the test year, and therefore the backhoe rental expense recommended by the Examiner is inadequate. The Company changed its position on equipment rental expense from that it took at the hearing, and it now contends that the Company should be allowed a backhoe expense of no less than $50/day and $2,600 annually. With regard to vehicle mileage expenses, the Company

asserts that there is no evidence in the record to suggest that Mr. Bowen's mileage estimates are incorrect. The Company states that Mr. Bowen's estimate of 10,260 miles traveled on Company business annually does not appear to be unreasonable, and should therefore be approved.

Finally, the Company took exception to the Examiner's finding that Botetourt Water be required to refund, with interest, all connection fees collected prior to March 5, 1998, over three years, in three annual installments. The Company states that a refund in these circumstances would be inappropriate and inequitable. In support of its position, Botetourt Water states that a refund of connection fees collected between 1994 and 1997 would create a windfall to these customers, and existing customers would be required to pay the utility a return on the utility plant installed for the sole purpose of serving the new customers. This, the Company contends, would violate the mandate of § 56-265.13:4 of the Code of Virginia, which requires that all customers be treated in a uniform manner. The Company also asserts that it has not violated § 56-265.13:5(B), which requires a utility to notify in writing all of its customers of any changes in its rates, charges, fees, etc., since the Company's customers are already connected to the water system and are not affected by the addition of a connection charge for new customers.

The Staff also filed comments on the Examiner's Report on February 6, 1999. The Staff took exception to the Examiner's recommendation that the Company be permitted to institute a connection fee for the installation of new water service connections in this proceeding. Staff stated that the Examiner properly found that the Company collected the fees illegally, and that such fees must be refunded to customers; however, the Staff believes that the Examiner erred in finding that the Company had satisfied the notice requirements of § 56-265.13:5(B) so as to permit instituting a connection fee in this proceeding. Staff also took exception to the Examiner's reliance on rate of return as the basis to establish rates since no rate of return analysis was performed in this proceeding.

NOW THE COMMISSION, having considered the Examiner's Report, the comments and exceptions thereto, the record herein and the applicable statutes and rules, is of the opinion and finds that the recommendations and findings of the Examiner, with the exceptions noted below, are reasonable and will be adopted.

At pages 11-12 of his Report, the Examiner discusses and recommends that Staff's expense adjustment for the use of a backhoe is a more reasonable estimate than that of the Company. Although no support was provided for use of the backhoe, we agree with the Company that the equipment rental expense

recommended by the Examiner is inadequate. We agree with the Examiner that the Staff's estimate of $430 is more reasonable than the initial $11,252 proposed by the Company (later changed to $2,600 in the Company's comments on the Examiner's Report), but we find that a reasonable expense lies somewhere between the two recommendations. We will allow $1,300 for the backhoe. We find that it is unlikely that each use of the backhoe was for a full eight hour day; therefore, we will allow $1,300, an amount that is more reasonable and consistent with the record in this case.

With regard to the salaries of Mr. and Mrs. Bowen, the office rental expense[1], and the vehicle mileage expense, we find that the Examiner's analyses and recommendations on these issues are reasonable and should be adopted.

In the future, we expect the Company to keep records of all its expenses, including actual time records for its employees, a mileage log for all company-related vehicle use, including the purpose of the trip, and a log for equipment use that contains

[1] We recognize that the Examiner misstated the size of the office as 5,400 square feet rather than 540 square feet; but, this error was clearly typographical since he previously stated the office size as 30' by 18'. We reject the Company's view that the Commission should assign 90% of the total annual rent expense to the Company since there are no longer active businesses operating out of the same office as Botetourt Water. The inactivity of Mr. Bowen's construction and real estate businesses does not automatically increase the allocation for office rent expense to Botetourt Water. Even though more space is now available to the Company, it does not necessarily require this additional space to conduct its business. Botetourt Water bears the burden of proving the necessity and reasonableness of its requested expenses, and it has failed to meet that burden.

the purpose and duration of each use of the backhoe and pressure washer. Not only should the Company keep records of these expenses, but it should also ensure that the expenses are reasonable, and Botetourt Water bears the burden of that proof. In this case, the Company's expenses are supported solely by Mr. Bowen's estimates of time, usage, and mileage. Additional support is necessary to justify the reasonableness of many of Botetourt Water's expenses.

The Commission also agrees with the Examiner that Botetourt Water did not provide notice to the Commission or its customers, as prescribed by §§ 56-236 and 56-265.13:5(B) of the Code of Virginia, and therefore did not have the legal authority to implement a connection charge in 1994. The Company's customers, therefore, were not given fair notice of the proposed fee, nor were they afforded the opportunity to comment or request a hearing. Thus, the Company is ordered to refund all connection fees collected since 1994. As the Examiner notes, any result other than a refund would permit the Company an unauthorized change in tariff. Although the Company's failure to comply with the law may have been unintentional, the applicable statutes nevertheless remain an important procedural safeguard to ensure a proper balance between the competing interests of the Company and its customers.

Further, we agree with the Staff that the Examiner erred in finding that Botetourt Forest had satisfied the notice requirements of § 56-265.13:5(B) so as to permit instituting a connection fee in this proceeding. The Examiner found that the notice contained in the Commission's March 18, 1998 Order for Notice and Hearing was sufficient to alert customers that a connection fee would be at issue in this proceeding. We disagree with that finding, and agree with Staff that only rates for those services that were specifically noticed could be affected in this proceeding. The Company's notice made no mention of fees for service connections. Rates cannot be implemented for a service that was not mentioned in the Company's notice. We therefore find that before the Company begins charging a connection fee in the future, it should submit the pertinent cost data to the Staff to justify an appropriate connection fee charge, and simultaneously give notice to its customers and the Commission of its proposed fee, as required by §§ 56-236 and 56-265.13:5(B) of the Code of Virginia. We have no authority to waive these statutory requirements for Botetourt Water. Since the statutory requirements have not been met, we find no authority to allow implementation of a connection fee at present. Therefore, we find that Botetourt Water shall refund all connection fees collected through the date of this Order,

and cease collecting such fees until proper notice and approval has been completed.

We also agree with Staff that since no rate of return or cost of capital analyses were performed in this proceeding, we should not use rate of return as the primary determinant of rates going forward. Instead, we will consider the Company's operating income. Under the applicable statute, § 56-265.13:4 of the Code of Virginia, the Company is entitled to recover a level of revenues sufficient to pay for its lawful and necessary expenses, and to compensate its owners for their investment in the system.

Based on the findings in this Order, the Company is entitled to an increase in annual operating revenues of $983, which should be achieved by increasing the consumption charge for monthly usage in excess of 2,000 gallons from $5.00 to $5.20 per thousand gallons. After the rate increase, the Company will earn $5,525 of annual operating income and a return on rate base of 15.28%.[2] We find that the rates, as established herein, are just and reasonable and will provide sufficient revenues for Botetourt Water to serve its customers.

[2] Although the rates established in this proceeding were not determined based on a rate of return analysis, we did consider the owner's investment and believe that a 15.28% return on rate base provides reasonable compensation for that investment.

In all other respects, the findings and recommendations of the Examiner are approved. Accordingly,

IT IS ORDERED THAT:

(1) The findings and recommendations of the Hearing Examiner as detailed in his January 8, 1999, Report, as modified herein, are hereby adopted.

(2) Consistent with the above-referenced findings, the rates for Botetourt Water shall be increased to produce additional annual revenues of $983 to generate $5,525 of net operating income, and a return on rate base of 15.28%, effective as of March 5, 1998.

(3) Within thirty (30) days from the date of this Order, the Company shall file with the Division of Energy Regulation a tariff for rates of service consistent with the terms of this Order.

(4) On or before August 4, 1999, Botetourt Water shall refund, with interest as directed below, all revenues collected from the application of the interim rates that were effective for service beginning on March 5, 1998, to the extent that such revenues exceed the revenues produced by the rates approved herein.

(5) The Company shall also be required to refund, with interest as directed below, all connection fees collected since

1994, in three annual installments, with refunds to be completed by June 1, 2001.

(6) Interest upon the ordered refunds shall be computed from the date payment of each monthly bill was due during the interim period or the date payment of the connection fee was due until the date refunds are made, at an average prime rate for each calendar quarter. The applicable average prime rate for each calendar quarter shall be the arithmetic mean, to the nearest one-hundredth of one percent, of the prime rate values published in the Federal Reserve Bulletin, or in the Federal Reserve's Selected Interest Rates ("Selected Interest Rates") (Statistical Release G. 13), for the three months of the preceding calendar quarter.

(7) The interest required to be paid shall be compounded quarterly.

(8) The refunds ordered in Paragraphs (3) and (4) above, may be accomplished by credit to the appropriate customer's account for current customers (each such refund category being shown separately on each customer's bill). Refunds to former customers shall be made by a check to the last known address of such customers when the refund amount is $1 or more. Botetourt Water may offset the credit or refund to the extent no dispute exists regarding the outstanding balances of its current customers, or customer who are no longer on its system. To the

extent that outstanding balances of such customers are disputed, no offset shall be permitted for the disputed portion. Botetourt Water may retain refunds owed to former customers when such refund amount is less that $1; however, Botetourt Water will prepare and maintain a list detailing each of the former accounts for which refunds are less than $1, and in the event such former customers contact the Company and request refunds, such refunds shall be made promptly. All unclaimed refunds shall be handled in accordance with § 55-210.6:2 of the Code of Virginia.

(9) On or before September 1, 1999, for the refund on interim rates, and July 1, 2001, for the refund of connection fees, Botetourt Water shall file with the Staff a document showing that all refunds have been lawfully made pursuant to this Order and itemizing the cost of the refund and accounts charged. Such itemization of costs shall include inter alia, computer costs, and the personnel-hours, associated salaries and cost for verifying and correcting the refund methodology and developing the computer program.

(10) Botetourt Water shall bear all costs of the refunding directed in this Order.

(11) If the Company wishes to implement a connection fee, it should submit the pertinent cost data to the Staff to justify an appropriate connection fee charge, and simultaneously give

notice to its customers and the Commission of its proposed fee, as required by §§ 56-236 and 56-265.13:5(B) of the Code of Virginia.

(12) The Company forthwith shall provide proper notice and submit a proper filing with the Commission seeking approval to serve customers outside its currently certificated service territory.

(13) The Company shall comply with the booking recommendations set forth on pages 19-21 of Staff Witness Barker's prefiled testimony, and shall provide evidence to the Director of Public Utility Accounting that these recommendations have been complied with within 90 days of the date of this Order.

(14) There being nothing further to come before the Commission, this matter shall be removed from the docket and the papers placed in the file for ended causes.